

Message Text

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PAGE 01 LONDON 00412 111132Z
ACTION EB-07

INFO OCT-01 EUR-12 EA-07 ISO-00 AID-05 CIAE-00 COME-00
FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03
SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15
STR-04 CEA-01 /087 W
-----111136Z 003414 /14

O R 111109Z JAN 77 ZFF (TRSY)
FM AMEMBASSY LONDON
TO TREASURY DEPT WASHDC IMMEDIATE
SECSTATE WASHDC 9322
INFO AMEMBASSY BONN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
USMISSION EC BRUSSELS
USMISSION OECD PARIS

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PASS FEDERAL RESERVE BOARD

E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: FOREIGN EXCHANGE MARKET REACTION TO THE STER-
LING BALANCE FACILITY

1. STERLING ROSE SHARPLY YESTERDAY IN NEW YORK ON THE
NEWS OF THE AGREEMENT, REACHING \$1.74 BEFORE CLOSING IN
THE \$1.7250 RANGE. BANK OF ENGLAND WAS CAUGHT UNPREPARED
BECAUSE NEWS OF THE AGREEMENT CAME FROM A LEAK ABOUT
6:00 P.M. LONDON TIME, WHEN RESPONSIBLE BANK OFFICIALS
WERE LEAVING OR HAD LEFT THE OFFICE. THE BASLE PRESS AN-
NOUNCEMENT OF THE COMMUNIQUE DID NOT COME UNTIL MUCH LAT-
ER IN THE EVENING, ABOUT 11 P.M. STERLING OPENED IN
LONDON THIS MORNING AT \$1.7285 WITH INITIAL MODEST TWO-
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PAGE 02 LONDON 00412 111132Z

WAY TRADING. THERE WAS THEN A LULL AND THEN FAIRLY ACTIVE
SELLING FROM PROFIT TAKERS, SENDING STERLING DOWN TO THE
\$1.7210-15 LEVEL AT 10:15 LONDON TIME.

2. MORE THOUGHTFUL LONDON FOREIGN EXCHANGE TRADERS SEE
THE BASLE AGREEMENT AS HAVING A PSYCHOLOGICAL IMPACT

RATHER THAN AN ECONOMIC ONE. IT WILL HAVE A BENEFICIAL EFFECT OF KEEPING OFFICIAL STERLING FROM BEING A DOWNWARD PRESSURE ON THE MARKET, BUT SOME DEALERS DO NOT BELIEVE THERE ARE MANY VOLATILE OFFICIAL BALANCES LEFT. NONETHELESS, THE AGREEMENT REMOVES AN UNCERTAINTY FROM THE MARKET. FOREIGN EXCHANGE DEALERS EXPRESS INTEREST IN THE TECHNICAL DETAILS OF THE FACILITY NOT ANNOUNCED IN THE COMMUNIQUE. THEY REMARK HOWEVER THAT THE BASLE FACILITY DOES NOT CHANGE THE UNDERLYING ECONOMIC SITUATION. HENCEFORTH. IT WILL BE THE U.K.'S INFLATION RATE, TRADE UNION MODERATION, THE THIRD STAGE OF THE SOCIAL CONTRACT, BASIC INDUSTRIAL EFFICIENCY AND SUCCESS IN EXPORTING THAT WILL DETERMINE THE EXCHANGE RATE. THE U.K. WILL NO LONGER BE ABLE TO BLAME DECLINES IN STERLING ON OFFICIAL BALANCE HOLDERS.

3. DEALERS IN MAJOR U.S. AND U.K. BANKS DO NOT THINK THE AGREEMENT WILL ADD MORE THAN 1-1/2 TO 2 CENTS TO STERLING DOLLAR RATE, IF THAT; \$1.73 TO \$1.74 SEEMS TO BE THE UPPER RANGE THAT OPTIMISTS SEE AND EVEN THOSE CONSIDER THAT GIVEN INFLATIONARY DIFFERENTIALS, STERLING WILL CONTINUE TO SLIP BACK TO THE \$1.60 TO \$1.65 RANGE, IN THEIR VIEW THE ONLY QUESTION BEING THE TIMING, I.E., WILL IT COME BY THE SECOND QUARTER OR BY THE FOURTH? THIS VIEW IS ROUGHLY CONSISTENT WITH THE JANUARY PHILLIPS AND DREW FORECAST OF THE EXCHANGE RATE, WHICH ON THE ASSUMPTION OF A STERLING BALANCE AGREEMENT WAS FORECASTING A \$1.60 EXCHANGE RATE IN MID 1977, WITH A TRADE-WEIGHTED DEPRECIATION OF 47 PERCENT SINCE SMITHSONIAN.

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PAGE 03 LONDON 00412 111132Z

ARMSTRONG

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NNN

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*** Current Classification *** LIMITED OFFICIAL USE

Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FINANCIAL RESERVES, FOREIGN EXCHANGE RATES, GOVERNMENT REACTIONS, NEWS LEAKS, STERLING (CURRENCY)
Control Number: n/a
Copy: SINGLE
Sent Date: 11-Jan-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977LONDON00412
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: n/a
Errors: n/a
Expiration:
Film Number: D770010-0148
Format: TEL
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770189/aaaafqgt.tel
Line Count: 103
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON MICROFILM, TEXT ON-LINE
Message ID: 1eede4dd-c288-dd11-92da-001cc4696bcc
Office: ACTION EB
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 2
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 03-Dec-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3676948
Secure: OPEN
Status: <DBA CORRECTED> mcm 970827
Subject: FOREIGN EXCHANGE MARKET REACTION TO THE STERLING BALANCE FACILITY
TAGS: EFIN, UK
To: STATE TRSY
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/1eede4dd-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009